Washington State
Community, Trade and
Economic Development

June 16, 1997

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Deputy Assistant Secretary
Strategic Petroleum Reserve
U.S. Department of Energy
FE-40, Room 3G-024
1000 Independence Avenue, SW
Washington, DC 20585

Subject: STRATEGIC PETROLEUM RESERVE POLICY COMMENTS

Dear Mr. Furiga:

Thank you for providing this opportunity to comment on Department of Energy (Department) Strategic Petroleum Reserve (Reserve) policy. The ability to rapidly dispatch large reserves of crude oil in the event that political turmoil interrupts world oil markets is an important lever the federal government can employ to protect the U.S. economy. However, the cost of this capability is a heavy burden for U.S. taxpayers, and the time has come to explore the possibility of privatizing the Reserve.

Washington advocates a federal petroleum policy that eliminates subsidies to the oil industry, fosters the development of alternatives both to petroleum fuels and to automobile transportation, and requires users of petroleum products to bear the full societal costs of petroleum consumption, including environmental costs, national security costs and the costs of hedging normal price fluctuations. With this vision in mind, we offer the following principles for operation of the Reserve:

- The purpose of the Reserve should be to ensure reasonable price stability in response to an emergency until the industry can respond by bringing more product to market. The size of the Reserve and the capacity of its facilities should be maintained at a level adequate for this purpose.
- Sales from the Reserve should be employed only in response to extreme political events. Hedging normal price fluctuations should be the responsibility of market participants.
- The cost of operating and maintaining the Reserve should be minimized, and should be funded through consumption of petroleum products, not through taxes.

These principles will inform our answers to the specific questions laid out in Department's Federal Register Notice.

1. ***Should the United States continue to maintain the Strategic Petroleum Reserve?***

   The state of Washington recommends that the Department replace the federally operated Strategic Petroleum Reserve with a carefully designed equivalent program, whereby retail petroleum distribution companies would be required to provide additional storage of crude oil and petroleum products. A privately owned and operated Reserve holds several advantages over continued federal operation:

   - The cost of maintaining the Reserve would be borne through consumption of petroleum products instead of taxes.
   - The Reserve would already be in the hands of distribution companies and would therefore not need to go through the auction process. This would greatly expedite the movement of needed products to market.
   - The Reserve could consist of petroleum products as well as crude oil without significant additional cost, enhancing implementation flexibility, reducing dependence on domestic refining capacity (which might also be affected by a petroleum emergency), and further enhancing the speed with which these products reach the market.
   - Multiple ownership and operation would result in a more geographically diverse Reserve. The Reserve would less susceptible to terrorism and would likely be held closer to major markets.

   However, the Reserve should not be converted to a government-subsidized instrument of the domestic petroleum industry. Any inventory requirement that is intended to substitute for a federal Strategic Petroleum Reserve should be in addition to normal industry inventory, and should not be available to the industry except in dire emergencies. The petroleum industry has developed a diverse array of tools to protect itself from the volatility of crude oil prices, and currently bears the full cost of employing those tools. Requiring companies to carry excess inventory for Strategic Reserve purposes would likely present a great temptation to avoid engaging in normal hedging policies. For this reason, the authority to allow violation of Department Strategic Petroleum Reserve inventory rules should continue to rest with the President, and strict penalties should be established for unauthorized violation. Enforcement costs should be borne by oil companies or consumers rather than by taxpayers.

   There are numerous other implementation issues, and the state of Washington reserves further judgment on the viability of privatizing the Strategic Petroleum Reserve until the Department develops a specific proposal. However, the Department is encouraged to explore this option to the fullest extent.

If the federal government opts to continue operating the Reserve, the state of Washington strongly advocates shifting the cost from taxpayers to consumers of petroleum products. Taxpayer financing of the Reserve constitutes a $200 million per year subsidy for the consumption of petroleum products. Such subsidies encourage the over-consumption of petroleum and exacerbate our dependence on imported oil, ironically the very problem the Reserve is intended to address. Placing the burden on oil imports would promote the rapid depletion of domestic reserves, while forcing domestic refiners to bear the cost would encourage increased importation of refined products. A tax on all petroleum products at the end-use level would be the most equitable and efficient means of financing Reserve operations.

2. ***What should be the size and composition of the Reserve facilities and oil inventory?***

   The state of Washington recommends that the Reserve and Reserve facilities be of sufficient capacity to ensure reasonable price stability in response to an emergency until the industry can respond by bringing more product to market. The exact size and disposition will change from time to time due to technical considerations, making recommendations on a pre-determined limit difficult. However, the state strongly recommends that the size and composition of the Reserve be determined by Department technical staff and not be subject to revenue pressures. Maintaining Strategic Reserves of refined products in addition to crude oil would enhance the flexibility and speed with which the Reserve could be tapped. However, the additional cost of constructing facilities for the storage of refined product as well as crude oil would probably exceed the benefits and should not be undertaken by the federal government at this time. Privatizing the Reserve would allow for Reserves to be held as refined product instead of crude for little, if any, additional cost.

3. ***How should the Reserve oil be distributed?***

   The state of Washington recommends no changes to the current method of competitive bidding for Federal Reserve oil, and strongly encourages the Reserve Office to maintain its policy of refraining from implementing its authority to allocate Reserve oil by any means other than competitive bid.

   Under a privately held Reserve, each company could employ its own portion of the Reserve as it chose.

4. ***What should be the drawdown and distribution capability for the Reserve?***

   The current drawdown and distribution capability of 3.9 million barrels per day is more than sufficient for the purpose of ensuring reasonable price stability in the event of an emergency.

5. ***What is an appropriate policy for revenue raising sales from the Reserve?***

   The state of Washington strongly recommends that the size of the Reserve be determined by Department technical staff in consultation with industry experts, and not by political revenue pressures. If the nation's foremost petroleum market experts decide that the Reserve needs to be of a certain size to provide the nation with price stability in the event of an international crisis, neither the Congress nor federal government should contravene that judgment through shortsighted measures to enhance government revenues.

6. ***Should the Reserve's facilities be available for alternative uses?***

   In theory, making Reserve facilities available to the private sector should benefit society by enhancing government revenue and by allowing industry avoid the need to construct redundant facilities such as storage drums, pipelines, and marine terminals. Due to political pressures, however, government has all too often failed to extract maximum value for its facilities and left itself open to charges of covert industry subsidies. Any process for selling or leasing Reserve facilities to private industry should be carefully designed, should be conducted openly and transparently, and should award the ownership or use of the facilities to the highest bidder. The state of Washington encourages the Department to make any surplus Reserve facilities available to other nations for strategic storage purposes.

7. ***Should the Reserve attempt to raise funds through alternative financing, innovative financial instruments, or buying and selling inventory?***

   The state of Washington does not recommend that the Reserve Office become active in private oil markets. The oil industry has well-developed futures and options markets and the Department should avoid competing with private suppliers of these services. Further, the Department would realize positive cash flows from selling and repurchasing or offering options on Reserve inventories only through accurate prediction of future oil prices, a task which confounds even the most expert and experienced industry analysts. It is fully appropriate for private citizens and corporations to risk potentially huge losses for the purpose of hedging future product prices or realizing profits from market speculation. It is not appropriate for governments to risk taxpayer money in the same way.

   However, if it becomes necessary to purchase crude oil for the purpose of replenishing the Reserve, the Department could engage in limited hedging practices to protect taxpayer money. Spreading purchases over a twelve month period, for example, would reduce the risk of buying at a market peak.

Once again, I thank you for the opportunity to comment on Strategic Petroleum Reserve Policy. I look forward to hearing the results of your inquiry.

Sincerely,

K.C. Golden
Assistant Director